

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

PRICE ELASTICITIES AND INTERNET
DIVERSION

Docket No. RM2014-5

ANSWER OF THE UNITED STATES POSTAL SERVICE
IN OPPOSITION TO PETITION TO INITIATE A PROCEEDING
REGARDING POSTAL DEMAND ANALYSIS
(May 9, 2014)

On May 2, 2014, a consortium of mailers filed a petition pursuant to Commission Rule 3050.11, seeking initiation of a proceeding to examine issues relating to price elasticities and other demand analysis matters.¹ The Postal Service submits that such a proceeding would serve no useful purpose, and therefore opposes the petition. The interests of both the Commission and the Postal Service are better served by focusing their scarce resources elsewhere.

The thrust of the Petitioners' claims is that events over recent years call into question, at least in their minds, the continuing validity of the Postal Service's econometric estimates of demand elasticities. See Petition at 5-11. To support their claims, they cite materials previously filed on their behalf in the exigent case. Yet while presenting their own views, and pointing to their own filings, they make absolutely no mention of other recent independent studies which have addressed the very questions they raise, and which have rejected the conclusions they once again wish to espouse. They likewise make no mention of the portion (pages 36-48) of the Thress Reply

¹ The parties submitting the petition (hereinafter, "Petitioners") are NPPC, AMEE, AMSP, GrayHair, GCA, IDEAlliance, MMA, and NAPM.

Statement (Dec. 6, 2013), also filed in the exigent case, which identified those studies, and further addressed head on similar allegations made by Petitioners in that case. Most disturbingly, they also ignore the fact that the Commission, in the exigent case, specifically considered the same materials they cite again here, and found those materials provided no suitable basis to support their claims that the demand for mail is more elastic than the Postal Service has estimated. Order No. 1926 at 152-157. Having failed to acknowledge these critical facts, the Petitioners obviously make no attempt to explain why a proceeding to rehash the same arguments the Commission previously rejected is appropriate at this time.

The Petition, moreover, is internally inconsistent with respect to two of its major supporting arguments. On page 9, as part of an attack on the Postal Service's approach to modeling the totality of factors affecting mail volume, the opinion is expressed that "the Postal Service's econometric model may be specified in such a way as to subsume price effects in other factors," and that "to the (unknown) extent that trends and intervention factors are reflecting what in fact are price effects, then the price elasticities generated by the model will be inaccurate." But on the very next page, the Petition acknowledges that "a consequence of this stability in real prices is that there has been very little price effect on volumes over [the years before and since the PAEA took effect], precisely because real prices have remained essentially unchanged." Yet simple logic dictates that if price effects have been minimal in recent years, they cannot possibly be the source of the enormous changes in actual mail volume which occurred over that period. In other words, the trend and intervention factors *cannot* actually be reflecting price effects. The muddled thinking exemplified by this contradiction in the

logic of the petition highlights the lack of substance in the reasons proffered to “doubt” the accuracy of the estimated price elasticities.²

While asserting that demand elasticities and other forecasting parameters are “analytic principles,” and thus under the purview of the Commission, the petition at page 12 is justifiably hazy on exactly what that means. Implicitly, the petition on page 12 is acknowledging that, unlike costing methodologies established in typical Rule 3050.11 proceedings, even if the requested proceeding were (unwisely) initiated, there is no clear path to integrating its results into the Postal Service’s forecasting procedures. The Postal Service explained why this is so back in the rulemaking to establish the periodic reporting rules. See Postal Service Initial Comments, Docket No. RM2008-4 (Oct. 16, 2008) at 22-28.

First, Section 3652(a)(1) requires the information the Postal Service provides in the ACR to “analyze costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe” Thus, the Commission has been authorized to direct the Postal Service regarding what costing methodologies to employ as it reports the costs necessary to evaluate compliance with the statute. Unlike costing methodologies, however, neither demand analysis nor

² It is somewhat ironic that Petitioners would seek to commence this proceeding now, when, as they concede, over recent years, real prices have been stable. Petitioners would argue that implementation of the exigent rate adjustment last quarter (although in our view relatively modest) has changed that situation, and the Postal Service will certainly be assessing the impact of the exigent rate increase and will continue the ongoing process of re-evaluating the demand equations, as it does with every new quarter of data. It would, however, likely require a number of quarters of post-exigent data to determine if there has been any change in the underlying demand relationships. In that sense, initiating a proceeding now would be premature, even if it were otherwise appropriate. Of course, for the reasons stated herein, it is not.

volume forecasting are included within the list of analyses for which the Commission is authorized to prescribe methodologies. In Docket No. RM2008-4, the Commission acknowledged the significance of the omission of demand topics from the statutory list of matters for which it may prescribe methodologies by rule. Order No. 203, Docket No. RM2008-4 (April 16, 2009) at 41.

Second, and perhaps more importantly, the natures of demand analysis and costing are fundamentally different:

Demand analysis is by nature more dynamic and fluid than cost analysis. In cost analysis, regression models are run that provide variability estimates that are usually applied without change over numerous years. In contrast, for demand analysis, once new input data become available, the demand model regressions are re-estimated in order to obtain the inputs necessary for forecasting. If, with inclusion of the new data, a prior model no longer provides the best basis for forecasting a particular type of mail, the model has to be adjusted to match the new “reality.” The task of incorporating new regression input data, rerunning the demand models, incorporating new econometric results into the forecasting models, and assessing the resulting forecasts, is a complex and necessarily iterative process.³ It commonly involves assessment of details of the models such as economic variables to include or omit, trend variables to include or omit, lag structures, and the like.

Postal Service Initial Comments (Oct. 16, 2008) at 26-27.

Despite these circumstances, the petition raises the prospect that one potential outcome of the requested proceeding might be for the Commission to specify by regulation “a particular volume and elasticity model,” although the petition

³ In costing work, the general progression of events is a perceived opportunity for improvement in the established methodology, an attempt to achieve such an improvement, and the opportunity for assessment of whether that attempt has succeeded or not. If the attempt is deemed unsatisfactory, there is usually the option to fall back to the established methodology. In demand analysis, work usually starts with new data applied to the existing models. If those models no longer work, then adjustments *have* to be made, because there is no option *not* to generate the updated forecasts upon which various functions of the organization rely.

simultaneously notes that such an outcome would then also likely require a need to “reconsider annually whether (and how) to adjust the econometric volume model.”

Petition at 17. In Docket No. RM2008-4, the Postal Service already established, for reasons that are equally true now, the infeasibility of such a process that contemplates “advance review” of changes in the demand analysis and forecasting models:

It is vital for the Postal Service to maintain control over the ability to forecast its own future, just as it would be for any large and complex business enterprise, and the Postal Service does not contemplate relinquishing control over its internal forecasting function. . . . [T]here is no practical opportunity to submit any such changes for advance review in the very short period of time between the availability of new data and the deadline for the production of updated forecasts. The Postal Service cannot compromise its ability to generate the best possible forecasts as quickly as possible for the sake of an advance review process that has never been employed for demand analysis in the past, and for which there is no demonstrated need currently. . . . If [an “accepted” set of models were specified], the Postal Service would have two options – surrender its ability to adjust demand equations as rapidly evolving circumstances warrant, or prepare one set of demand equations for use in forecasting, and a separate set for use in periodic reporting. Under the second option, the Postal Service would make necessary model adjustments to estimate elasticities to use in its internal forecasts, but make no model adjustments (and hence no changes in “analytic principles”) to generate another set of elasticity estimates based on the old models and new input data. The latter set of elasticities would be those reported to the Commission. Note, however, to the extent that such “reported” elasticities differ from the forecasting elasticities, they would necessarily be inferior, because model adjustments made to generate the forecasting elasticities would likely be motivated by specific perceived deficiencies in the results of the old model (i.e., the “reported” elasticities). Putting the Postal Service in the position of generating two sets of elasticities, and reporting the inferior of the two sets, would not seem to be in the interest of anyone.

Initial Comments (Oct. 16, 2008) at 26-29. In responding to these comments by the Postal Service, the Commission in Docket No. RM2008-4 avowed an intent to minimize interference with postal management’s administration of its forecasting capability, and declined to pursue “advanced review” or to establish an “approved” set of models.

Order No. 203 (April 16, 2009) at 43. That sentiment is no less appropriate today than it was then. While Petitioners are eager for the Commission to embark on a proceeding, they have presented no realistic objective that warrants the time and effort such a proceeding would require, both immediately and, apparently, every year thereafter.

One other aspect of the petition, on its own, requires its rejection. Petitioners have overtly sought to inject consideration of major issues currently before the Court of Appeals with regard to the exigent rate increase. See Petition at 7-10. The (unmeritorious) claims made in the Petition which overlap with the issues before the court, however, have little bearing on the ostensible focus of the proceeding they seek to instigate – the validity of the price elasticity estimates.⁴ Petitioners purport to avoid this difficulty by claiming in a footnote on page 4 that the merits of the exigent appeal will be decided on the existing record in that docket. Petitioners know full well, however, that the court may remand the matter back to the Commission for further proceedings. If that were to occur, whether by design or not, a proceeding addressing the issues as framed in the petition would unduly and unnecessarily complicate any such remand.

Note that, by urging rejection of the petition to initiate a proceeding, the Postal Service is not suggesting that Petitioners (or anyone else) should not be free to pursue whatever analyses of postal demand they wish to conduct. As Petitioners acknowledge, the Postal Service files its models, with supporting data, each year. Alternative analyses could be conducted if anyone were so inclined. Obviously, since Petitioners cite survey research already conducted on their behalf, they can likewise engage in

⁴ Petitioners on page 10 characterize a quotation from page 63 of Order No. 1926 as evidence of a linkage made by the Commission between “price effects” and the alleged deficiencies in the model’s treatment of electronic diversion, but, in reality, the quotation neither suggests nor implies any such linkage.

whatever market surveys they wish to pursue. There is no shortage of fora in which the results of any such efforts could be presented and, potentially, published. To the extent that Petitioners believed those results to be relevant to a specific Commission proceeding, they could, as they did in the exigent case, submit their material at that time. Petitioners, however, have made no showing of why the involvement of either the Commission or the Postal Service is necessary now in order for them to explore these matters as actively as they wish.

For the above reasons, the Postal Service respectfully urges the Commission to reject the petition, and decline to initiate the requested proceeding at this time.

Respectfully submitted,

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